EDITORIAL

Financial Inclusion:
Social Inclusion with its true Paradigm to be the Target!

"The believing men and believing women are allies of one another. They enjoin what is right and forbid what is wrong, and establish prayer and give zakāh and obey Allah and His Messenger". (Qur'ān: 9:71)

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The generic term of 'financial inclusion' has been in use for last many years not only in developing but also developed economies referring to the schemes to combat the issue of 'exclusion' of the people of small means from the formal financial services and to promote community reinvestment. The terms micro finance and micro credit to those who do not have access to the formal institutions are the major indicators of financial inclusion, although accounts opening and use of mobiles by the poor for banking services are being increasingly considered as a measure of financial inclusion particularly in India, Bangladesh and Sub-Saharan Africa. Further, microfinance and financial inclusion are the major elements in achieving the Millennium Development Goals (MDGs).

The Finance and Markets Global Practice (FMGP), of the World Bank Group (WBG) has led reforms in more than 100 countries that pertain to legal frameworks, large value payments programs, retail payment systems, government payments, interbank money markets, securities settlement systems, remittances, oversight frameworks and cooperative frameworks. The Financial Inclusion Support Framework (FISF) makes grant funds available through region-led technical assistance projects that enable the WBG to provide multi-year technical-assistance programs to match countries' multi-year financial inclusion and financial literacy strategies and targets. More than 15 countries requested assistance for financial inclusions programs (FIP), and projects initiated in five countries – Indonesia, Mozambique, Rwanda, Pakistan and Zambia – which are expected to be completed between FY15 and FY17[1].

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[1] Financial Inclusion Overview;
http://www.worldbank.org/en/topic/financialinclusion/overview#1

The Microfinance Meltdowns

The use of term ‘financial inclusion’ has been made more formal after the ‘microfinance meltdowns’ since 2008. The facts concerning impact of microfinance programs are complicated and controversial (Stewart *et al*, 2010). The main finding of the study by Stewart was that some people were made poorer by microfinance, particularly micro-credit clients, while some others took their children out of schools, one reason of which was that their businesses failed to produce enough profit to pay high interest costs (P.48). Sinclair (2012) indicated in his book that that nine out of 10 microfinance loans had been given for consumption rather than to start or grow an enterprise, or even to buy food or clothing.[2] Even Dr. Muhammad Yunus of Grameen, who asserted while receiving the Nobel Prize in 2005 that he wished to set up a good, affordable, microfinance institution that would enable the poor to work their way out of poverty with fair price credit, lamented subsequently by saying, “*I could never believe that the microfinance institutions have become the very same evil money lenders that we attempted to replace.”* Some other studies (e.g. Adams and Von Pischke 1992) also highlight negative effects, such as the maltreatment with women, unaffected poverty percentages, higher income inequality, elevated workloads, soaring interest and creating hurdles to ongoing local financial and community development. The main issues responsible for this failure had been identified as high rates of interest, rampant corruption and woefully low level of transparency. “If we want to take out the best of whole microfinance concept, it is time to reconstruct the microfinance industry in suitable ways” (Sinclair 2012).

The ‘microfinance meltdowns’ phase started in 2008 in South East Asia and Sub Saharan countries that manifested huge over-indebtedness of the clients, massive client withdrawals, and the key MFIs plunging into loss or forced to close or merge. The most serious cases were that of Bosnia (2009) and Indian State Andhra Pradesh (2010). Some mega finance groups like Deutsche Bank, Citibank, Standard Chartered, Triple Jump, ASN Bank, etc had invested for high returns in institution like LAPO Microfinance Bank (West Africa), Grameen Foundation, etc. One major problem with Muhammad Yunus was that the Grameen Foundation was, in fact, one of the investors in LAPO, one of the earliest investors and guarantor to loans from Citibank and Standard Chartered.

The above may imply that the terms like financial inclusion and financialization may practically be considered as the process of expanding

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[2] Sinclair, 2012; *Confessions of a Microfinance Heretic: How Micro lending lost its Way and Betrayed the Poor*.

the finance sector relative to the size of the total economy, continuously reducing the commodities related sectors as contributor to GDP in various economies.

Potential of the 'Financial Inclusion' Programs

It's clear from the above that the financial institution programs with their focus to maximize profits for the shareholders have tendency to making the poor and the people lacking collateral as the *'no-go'* area. But those who entered the micro credit sector created mess only in a few years. According to the latest policy, the idea of financial inclusion has been linked to the wider increases in income inequality arising from the competitive operations of financial institutions. But the question is: What safeguarding measures have been taken to avoid the failures? Serious problems had been seen because of the poor transparency and lack of proper regulatory controls. Even more important aspect is that of the basis of providing finance; no one is considering that how a scheme with new name with same institutions aiming maximization of profits by charging interest from the poor could lead to better income distribution in the societies. According to The Economist (Jan. 2013), the fundamental causes of the crisis had been tradition of (ab)using debt as a tool of social policy. Mader Philip concluded in a paper (2013) about micro finance in India, "*If there is one key lesson to be learnt from this more contextualized account of the Andhra Pradesh microfinance crisis, it is that deeper-seated social problems cannot be resolved with an infusion of debt, and that industries built on that premise are bound to fail eventually*"[3].

The main issue is that earning maximum profit at any cost has become the sole purpose of human existence that, of course, has marginalized and impoverished the masses by the riches of a few. The report on a Christian-Muslim Interfaith Dialogue held in Malaysia expressed concern over this in the following words, "*A recognition that the economy is simply a means to higher ends—such as happiness, belonging and security-- should make us realize that merely changing the means, for instance by substituting one form of livelihood or economic system with another, does not constitute meaningful change and genuine progress.* This happened as a part of the neo-liberal economics and by means of '*social legitimatization of vices such as greed and pride in the societies*'[4].

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[3] Mader, Philip (2013): *Rise and Fall of Microfinance in India: The Andhra Pradesh Crisis in Perspective*.

[4] Vision in Action (*ViA*) Advisory Group, Report on Christian-Muslim Interfaith Dialogue on "*Engaging Structural Greed Today*" in Kota Kinabalu, Sabah, Malaysia; September 25—30; 2011.

Even Islāmic financial institutions (IFIs) have become increasingly risk averse, financing mainly the public sector or private sector big corporate entities to remain competitive with their counterparts with regard to profitability. *Ṣukūk* that were conceptually designed to broaden the ownership of the larger assets through risk sharing based investments are treated as 'debt securities' or so-called 'Islāmic bonds' used mainly for the sovereigns or larger size projects. *"Bringing a ṣukūk to market for a blue-chip telecom is more glamorous than running a risk assessment on a local manufacturer"*, remarks Douglas Johnson (2015). Consideration for ethics as warranted by equity and justice and CSR is being consistently neglected. Hence, the focus on the bigger segments does not seem to be spilling over into support for small and medium-sized businesses.

Need to Identify the Persistent Cause of the Failures and Crises

The neo-liberal economic system, as a whole, is based on earning maximum money from money by way of interest, short selling, gambling, increasingly complicated instruments and finance structures without proper disclosures and transparency. In the prevalent system, *"money does not exist without debt, debt does not exist without interest, and interest drives us to earn more and more money*"[5]. No one, particularly those sitting at the helm of affairs, is ready to accept that the risk shifting instead of risk sharing, and creating interest bearing money and credit without taking notice of its impact on income distribution is the fundamental cause of exploitation of the poor by the rich and the recurring economic and financial crises in the world.

Scarcity amidst abundance and interest which are hallmarks of the current financial system are products of the money that is lent into existence by the banking and the exchange systems. Interest provides the motivation for the sovereigns and the banking system to create money with objective to get hold of fresh resources and maximize the profits. Although there is material plenty as a whole - that perhaps has never been before in human history, and we have the capacity to easily fulfill all the physical needs of every human being on the planet, yet there is wide-spread hunger and deprivation on the one hand, and separation of the individuals and dismantling of the societies on the other.

Social Inclusion with its true paradigm to be the Target

The above discussion may imply that the slogan of financial inclusion has to be replaced with the social inclusion that may imply "*full and fair access to collective resources and activities; the maintenance of social*

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[5] Charles Eisenstein; *The Ascent of Humanity*, 2007.

relationships with the family, friends and acquaintances, and the developing of the sense of group belongingness "[Cobigo, cf. R. Aparicio 2013] [6]. Social inclusion is a natural enemy of poverty, which hinders the satisfaction of basic needs, prevents exercising human rights and limits the horizon of people's participation in society, either as an individual or as social group" (R. Aparicio 2013).

According to UNESCO (2012), an inclusive society is built on the fundamental values of fairness, equality, social justice, human rights and freedoms, participation in decision making, as well as on the principles of tolerance and recognition of the diversity. The World Bank defines social inclusion as "the process of improving the terms for individuals and groups to take part in a society. It is both an outcome and a process of improving the terms on which people take part in society"[7]. Sen (2000) defines an inclusive society as the one where there is a widespread sense of shared life experiences, active social participation, equal opportunities and universal enjoyment of basic levels of wellbeing. Hence, an agenda for inclusion should aim at establishing a society whose members socialize with one another in all events, implying social cohesion, and care for rights of all in a society and poverty reduction.

How Islāmic Finance Can Lead to Social Inclusion?

Islāmic finance has been conceived as a means to move to risk sharing from the conventional interest based risk shifting system. However, when it evolved it abandoned risk sharing and focused on synthetic structures to imitate the conventional innovative products. Hence, IFIs are exposed to same credit, market and systemic risks, as their counterparts face. Rather, the risks facing them might be even higher as they have to be compliant with the Sharī'ah at least legally or in the form.

Douglas Johnson in his recent article expressed concern by saying, "*as momentum in Sharī'ah-compliant banking shifts from high-growth to maturity, industry executives could run into hazards, given the hubris spawned by their success*". He compared Islāmic finance with '*Shockwave 5*' that was one of the world's most expensive racing yachts with the best crew anywhere, but sailed headlong into a rocky ledge as the principal

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[6] Ricardo Aparicio, paper for workshop on "*Measuring Social Public Policies: Inclusiveness and Impact*" UNESCO; Paris 25, 26 March 2013. http://www.unesco.org/new/fileadmin/MULTIMEDIA/HQ/SHS/pdf/Workshop-Social-Inclusion_CONEVAL.pdf

[7] Social Inclusion (2013); http://www.worldbank.org/en/topic/socialdevelopment/brief/social-inclusion

helmsman showed "*no concern about the navigation situation*"[8]. It can guide IFIs in assessing the future of Islāmic finance, he cautions.

As the first priority of investors / deposit holders in Islāmic finance is the Sharī'ah compliance and thereafter the return, IFIs need not be and cannot be the competitors of the conventional institutions. Instead, they need to facilitate the real, small and medium business and productions units and corporate entities to provide better and stable link between the real and the financial economies. They may allocate a part of equity and the deposit base to finance financially week segments that are not able to get required funds in competitive financial markets due to higher cost or collateral requirements. Enabling small entrepreneurs and farmers to produce goods and services at affordable costs may benefit the society and the economy through a number of linkages. The resultant strength of the Islāmic financial system will make its own space and the conventional institutions will adopt the same approach to cater to the clientele insisting on widely accepted ethics and Divine principles of business contracts.

The regulators may ensure the high levels of transparency with regard to the bases, the process and implementation of *fatāwá* or products approval by the Sharī'ah boards of the IFIs. The justification of *fatwá* should be detailed and made publicly available. Moreover, such *fatāwá* have to be unified at the regulators levels. Muddassir Siddiqui, a US trained attorney and jurist associated with AAOIFI and other IFIs, observes in this regard, "it should be mandatory for all *fatāwá* to be deposited with a unified regulatory authority that will be responsible for publishing them for easy public access. This will also ensure that all *fatāwá* can be categorized within a specific framework".

The Way to achieving Social Inclusion

Social harmony and risk sharing are the basic elements of social inclusion, in addition to developing the sense of group belongingness in a society. In the light of the injunctions of Islām, it would imply sharing of benefits and possible risks / losses through mutual efforts and cooperative partnership. As ordained by the Qur'ān [5:2] (*O you who have believed, …cooperate in righteousness / justice and piety, but do not cooperate in sin and aggression*), Muslims have to help one another in all matters of common concern. However, very first measure in this context would be to stop the conversion of social capital into financial capital as presently is the case of

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[8] Islamic Finance: A Shockwave in the Making; http://www.islamicbanker.com/articles/islamic-finance-shockwave-making

all finance related approaches. According to Islāmic principles, the capital and the talent / expertise have to be combined by way of sharing the risks as well as rewards instead of interest charge and the credit transactions for that purpose. Following steps / institutions are suggested in this regard:

1) Changing the Money and Credit Creation System

As interest is the main source of conversion of social and community capital into money capital, any alternative currency system to be considered is one that structurally eliminates interest, as Islām, Catholic Church and other divine religions so require. Silvio Gesell had proposed a structural solution in his book, "*The Natural Economic Order* (1916), which he termed as "*free-money*". The main feature of such money was that instead of generating interest and getting, a "user fee", a "maintenance cost" was charged by affixing a periodical stamp. Also praised by J. M. Keynes, such currency was instituted in Worgl, Austria, in 1932. Money, instead of earning interest, became a burden; people spent their income quickly, generating economic activity in the town. "*The unemployment rate plummeted even as the rest of the country slipped into a deepening depression; public works were completed, and prosperity continued until the Worgl currency was outlawed in 1933 at the behest of a threatened central bank*" (Eisenstein 2007).

The serious people from academic and policy making circles have to think to change the money and credit creation system to make it human friendly. As described by Eisenstein, social capital is the totality of human relationships that sustains life and makes it rich. The social and spiritual capital has been converted into money. Humanity has lost 'community, connection to nature, play, intimacy and trust in providence'. Monetization of human relationships has rendered the human beings merely robots. The parents are victims of a monetization of life that has spread the need for efficiency into life's every corner. The culture of "*mom joining the workforce*" and "*stay-at-home dad*" has dismantled the extended family concept. It has been the instrument of the destruction of love, truth, beauty, spirit, nature, and community.

Since the dismantling of the Bretton-Woods system in 1971, money is created by making loans depending upon banks' own reserve ratios and the discount rate, and through the purchase and sale of government securities by the central banks. Hence the interest based debt system increasingly corrupted the whole system and all aspects of human society.[9]

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[9] Fed: Gap Between Rich, Poor Americans Widened During Recovery ; http://blogs.hbr.org/2014/09/american-wealth-gap-widens-despite-economic-recovery/

2) Establishment of a Cohesive Society

The main ingredient of social inclusion would be establishing a cohesive human society where there is a strong and extended family system, all members of which behave like members of a family, help and indemnify each other, and respect the rights of others even by leaving some of their own rights. Members of such society would compete with one another in terms of efficiency and performance in business and economic activities, but without deceiving others, or the competition being cut-throat; face the hazards or calamities with mutual efforts, enjoin good deeds and forbid what is bad or wrong, and ultimately come to believe that *'a society is happy, if all of its members are happy'*.

Such society is based on the belief and sense of accountability to the Creator of the universe. Holy Qur'ān says in this context, *"The believing men and believing women are allies of one another. They enjoin what is right and forbid what is wrong, and establish prayer and give zakāh and obey Allah and His Messenger"* (9:71). This theme is found in a large number of *a hadith* of the Holy Prophet (pbuh), a couple of which, as reported in *Sahih al-Bukhārī*, are given below:

> "*The example of the believers in their affection, mercy, and compassion for each other is that of a body. When any limb aches, the whole body reacts with sleeplessness and fever."*
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> *"The* believer for another believer (in a community) is *like* that of a well-compacted building where one part *of* the building strengthens the other".
>
> *"He is not a believer whose stomach is filled while the neighbour to his side goes hungry".*

3) Revamping the State Policies

The State policies with respect to fiscal and monetary operations need thorough appraisal and revamping. Taking example from Pakistan, the GoP / central bank have launched a number of schemes for financing the agriculture, small businesses and SMEs. Keeping in view the lacklustre approach of banks to finance such micro sectors due to lack of collateral, the SBP has also introduced a (partial) Credit Guarantee (PCG) Schemes for the banks. (Such PCGs have been operational in developed countries for over four decades while their use in developing countries is more recent). But the main issues of the cost of such loans (interest charge) and the rising cost of the inputs have to be addressed. The ground reality is that indirect taxes, particularly, the GST levied on agricultural inputs, is working as a double-edged sword for the farmers' community, micro level

commodity producing units and the SMEs. The farmers are caught between two hard realities, the ever-increasing cost of production and sliding prices of their output due to competitive global market prices. It has eroded their competitiveness in the international market causing huge loss to the economy in terms of exports. Higher credit cost could accentuate their problems and cause further loss.[10] The government would be much wiser to revise the strategy and tax regime to reduce input costs rather than facilitating banks to provide high cost loans.

4) Restructuring the Pyramid of Corporate Social Responsibility

In recent years much has been said about ethical finance and the CSR. However, there is need for restructuring the pyramid of CSR[11]. As per the stakeholders approach, it is increasingly accepted that a 'socially responsible' firm has to obey the law, be ethical, and be a good corporate citizen while striving to make profit. Even Milton Friedman who is considered the most outspoken proponent of shareholders approach had posited that "*to make as much money as possible while conforming to the basic rules of society, both those embodied in the law and those embodied in ethical custom*" (Friedman 1970)[12]. The stakeholders approach has to include society and all its segments leading to ensure that the basic rights and needs of all are suitably satisfied.

Both the terms of ethical finance and the CSR are used for limited and prejudiced meanings to exclude the interest based and windfall gains by the institutional moneylenders through interest based money and credit, speculation, short selling, gambling and exotic derivatives. Based on the experiences of the global financial crises since 2009, it seems essential to enlarge the CSR scope to also include the banking and finance sectors so that they are made to observe economic, ethical, legal, social and philanthropic responsibilities.

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[10] Another example is imposing 0.6 % withholding tax on sums exceeding a limit in a day on non-filers of tax returns (Finance Act 2015) with a plan to collect huge sum of Rs 30 billion. Besides protests, many people heve been reported considering of closing their Bank Accounts. The members of Income Tax policy team must understand that every bank account holder in a country where one half of the population live under poverty line ($2 minimum daily wage) [Ishaq Dar, Finance Minister, Dawn, June 3, 2014], cannot be Income Tax payer. It would certainly lead to exclusion, both financial and social.

[11] Carroll, Archie B (1991); *The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders*; Business Horizons, July-August.

[12] Milton Friedman is said to have argued that social matters are not the concern of business people and that these problems should be resolved by the unfettered workings of the free market system. But his assertion is not considered in totality. (Carroll, 1991).

5) Promoting the Venture Capital Institution

The risk-sharing system needs to be re-emphasized both by the public and the private banking and non-banking financial institutions as well as at the State's level. Murat Çizakça, an eminent researcher in Islāmic economics and finance, has presented case studies of 13th century Venice, 19th century Germany and the 20th century USA, which show the histrionic achievements of risk sharing in the West[13]. Promoting venture capital in public-private partnership for investments in micro and medium size projects and businesses is one such mechanism to re-introduce risk sharing system into the modern Islāmic finance that could create real difference for broad-based development and balanced growth and ultimately for effective social inclusion. In addition to the fact that the institution of venture capital is in harmony with the principles of Islāmic law of contracts, it has played crucial role for development in USA and Europe. Çizakça has also discussed the principles and suggestions for establishing a vibrant venture capital sector.

6) Establishment of Cash *Awqāf*

A large number of wealthy persons in Islāmic societies may be eager to help the indigent and spend their wealth for social welfare. There has to be specific institutions to formalize such welfare works and organizations. This can be accomplished with revival of the institution of '*Waqf*' or more specifically the 'Cash *Waqf*'- the cash capital donated perpetually by the philanthropists might be invested on the basis of risk sharing[14].

7) Need for Distinction between the Potential Entrepreneurs and the mere receivers of Funds

While planning for any program of providing funds for Micro / SME sectors or small farmers, there is a need to focus more specifically on effort to choose the entrepreneurs, rather than treating every one as a potential entrepreneur (Stewart *et al.* 2010). Those, who do not have entrepreneurial potential, have also to be distributed between two categories of the poorest and indigent needing funds for meeting their consumption needs, may be from *zakāh* funds / charities, and those who may need some bridge loans for their social or production needs repayable at the harvest or time of cash flow. This distinction will be helpful in

[13] Murat Cizakca, "*Risk sharing and risk shifting: An historical perspective.*" Borsa Istanbul Review; Volume 14, Issue 4, Dec. 2014; http://www.sciencedirect.com/science/article/pii/S2214845014000258

[14] Murat Cizakca; *A History of Philanthropic Foundations: Islamic World from the Seventh Century to the Present* (Istanbul: Bogazici University Press, 2000).

treating different groups according to their capacities, needs and possibility of permanent rehabilitation of the extreme poor, the weak & sick and the disabled. 'AKHUWAT' presently working in Pakistan mainly on the basis of *qard al-hasan* is in position to serve as a role model in this regard.

8) Formation of Community Associations

Effective social inclusion needs forming community associations at city, town and even village levels to create such cordial relationships amongst members of a society that they help one another in all time of sorrow and happiness. It would provide opportunity for broad based consultancy among community members, prevalence of good, ethical and healthy deeds and habits, vigilance against anti-social activities and establishment of social & economic welfare centres at various levels. Such associations may also establish *awqāf*, charities and launch various schemes for mitigating losses to the community members through cooperative *takāful* schemes, as discussed in the next section.

9) Developing Community *Takāful* System

A mutual and community based *takāful* system based on *mushārakah al-ta'āwuniyah* (mutual cooperation, protection and responsibility) is a special feature of Islāmic culture that can be traced back to some pre-Islām historical systems including, *inter alia*, *al-nahd* (as we discussed in Editorial to the JIBM Vol.3 No.2, 2013). The cooperative entities serving as the '*Mutuals'* would aim at community well-being at grass-roots levels. Various community organizations, charities, *waqf* funds and the individuals would become its members to pay donations/contributions to a common pool managed by the representative of the respective community. Such '*Mutuals'* may also serve the function of Fund Managers for investment of the pool's or its members' savings and funds as also give *qard al-hasan*, or even grants for consumption by the poorest, or for small businesses by those who have potential to be entrepreneurs. This mutual system could also be used as a vehicle for savings / investments and house construction / motor vehicle / education /marriage, etc. IFIs may also become members of such organizations as part of their community services programs that could be funded from banks equity, current accounts balances, or even the 'Charity Accounts' for help to the indigent and the poorest. Community *takāful* in the proposed structure could become an institution for social and financial inclusion of those who either abstain from the banking and insurance due to Sharī'ah prohibitions, or are

not in a position to approach conventional institutions due to some deficiencies.

10) Enabling role of the State

To fulfill basic and genuine needs of all members of the society, the State has to ensure that the rogue members of the society do not exploit others or create problems for them. Further, proper implementation of the proposed entities and the community system would also require facilitative and regulatory support from the State institutions like local civic administration, Registrar of Companies, Securities Commissions, Ombudsman’s offices and even the monetary and finance authorities. The governments, regulators, think tanks and scholars must support localized, small-scale, community-level institutions. At the outset, the focus needs to be on social security and mutual help institutions.

We can conclude that efforts at achieving higher growth rates of economies without caring for the widening gap between the rich and the poor can never lead to sustainable prosperity even of the selected groups. Similarly, initiating ever new schemes with limited objectives of providing funds to the ‘*financially excluded*’ or facilitating the banks to finance such segments without taking care of other issues, as we discussed here, might not be really fruitful. The present system has eroded the social capital and to make any measures or schemes really useful, the target needs to be broad-based social inclusion by reviving the risk sharing and community based cooperative institutions. Islāmic banks and financial institutions, in order to provide a real alternative to the present corrupt system, have to take the lead to be innovative for proper linkage between the real and the finance sectors of the economy, not for replicating the conventional products. This can be accomplished only if the Sharī‘ah fraternity firmly resolves not to approve any products that are not Sharī‘ah compliant both in letter and spirit. Here comes the role of AAOIFI or Islāmic *Fiqh* Council. For generating large scale prosperity and welfare of the society as a whole, the State and the regulators have to intervene to ensure that the poor are not deprived of the benefits of growth simply because of their poverty. In addition to ensuring that all segments are provided with equal opportunities to prosper, some special schemes and arrangements are needed both in the public and the mutual / cooperative sectors to enable those who are not able to fulfil their basic needs to live a healthy and respectable life.

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